

Message Text

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C O N F I D E N T I A L BONN 02961

LIMDIS GREENBACK

PASS TREASURY AND FEDERAL RESERVE

E.O. 11652: GDS

TAGS: EFIN, GW

SUBJECT: GERMAN FOREIGN EXCHANGE MARKET AND
INTERVENTION POLICY

1. DURING A VISIT THIS WEEK TO FRANKFURT THE
FINANCIAL ATTACHE ENCOUNTERED GENERAL SKEPTICISM
AMONG MOST PRIVATE BANKERS WHETHER THE DOLLAR WOULD
BE ABLE TO MAINTAIN ITSELF AT CURRENT LEVELS VIS-A-VIS
THE DM. MOST THOUGHT THAT AT THE VERY LEAST A DIP
BELOW \$1 EQUAL DM 2.30 WAS VERY LIKELY.

2. THERE WAS A GREAT DEAL OF CRITICISM CONCERNING THE
RECENT CENTRAL BANK ANNOUNCEMENT OF INTERVENTION POLICY
WHICH ACCORDING TO THE BANKERS DID THE OPPOSITE OF
"SMOOTHING THE MARKET" BY PUSHING THE DOLLAR UP TO
DM 2.38 ONLY TO HAVE IT DROP AGAIN TO THE LOW 2.30'S
IN RESPONSE TO CHANGES IN US REDISCOUNT AND INTEREST
RATES.

3. BUNDESBANK BOARD MEMBER TUENGELER TOLD THE
FINANCIAL ATTACHE THAT HE HOPED IT WOULD BE POSSIBLE TO
"DEFEND" THE DOLLAR/DM RATE IN THE \$1 EQUAL DM 2.30 TO
2.40 RANGE, EVEN THOUGH HE EXPRESSED DISAPPOINTMENT WITH
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THE RESULTS SO FAR OF BUNDESBANK/FEDERAL RESERVE

INTERVENTIONS. TUENGELER SAID THAT HE THOUGHT THE DOLLAR WOULD REMAIN WEAK UNTIL THE US ECONOMIC SITUATION IMPROVED. IN PARTICULAR HE STRESSED THE IMPORTANCE IN THIS CONNECTION THAT THE US ADOPT A MEANINGFUL AND SIGNIFICANT PROGRAM OF CUTTING ENERGY IMPORTS.

4. WHILE IN NO WAY EXPRESSING DISSATISFACTION WITH PRESENT US/GERMAN INTERVENTION ARRANGEMENTS, TUENGELER REPEATEDLY MENTIONED THE "ANOMALY" THAT THE BUNDESBANK BORE THE FULL EXCHANGE RISK ON ITS PART OF THE INTERVENTION WHILE THE RISK ON THE SWAP FINANCED INTERVENTION BY THE NEW YORK FED WAS SPLIT 50:50 BETWEEN IT AND THE BUNDESBANK. TUENGELER SEEMED TO BE PROBING WHETHER THE FED OF NEW YORK WAS RESTRICTED BY THE FEDERAL RESERVE BOARD OR THE TREASURY IN ASSUMING A MORE EQUAL PART OF THE TOTAL RISK. THE FINANCIAL ATTACHE DID NOT RESPOND TO THIS OTHER THAN WITH AN ASIDE THAT HE THOUGHT THAT IN THE PAST THE "MARKET SMOOTHING" TYPE OF DM/DOLLAR INTERVENTION USUALLY HAD ENDED WITH A PROFIT FOR THE CENTRAL BANKS. TUENGELER AGREED, BUT THOUGHT THIS TIME THIS MIGHT WELL NOT BE THE CASE--IT DEPENDED ON HOW LONG THE CENTRAL BANKS COULD WAIT BEFORE REVERSING THE SWAP.

5. CONCERNING GERMAN LONG-TERM BOND INTEREST RATES, MOST PEOPLE AT THE BUNDESBANK THOUGHT THAT THEY WOULD COME TO A "SOFT LANDING" AT ABOUT 8.5 PERCENT. ONLY SCHLESINGER (RESEARCH CHIEF) SEEMED TO THINK THAT THEY WOULD DROP SOMEWHAT FURTHER BELOW THAT. BUNDESBANK ECONOMISTS NOW SEE 1975 REAL GROWTH SOMEWHAT BELOW THE PREVIOUSLY FORECAST 2 PERCENT, WITH THE PRICE DEFLATOR AT ABOUT 5 PERCENT AND THE NET FOREIGN BALANCE NOT MUCH CHANGED FROM 1974. UNLIKE MANY PRIVATE BANKERS THEY STILL SEE THE UPTURN IN PRODUCTION STARTING BY NEXT SUMMER.
HILLENBRAND

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